

# **Kansas Registered Investment Adviser -Guidelines-**



**This publication is not all inclusive but is intended to address those areas that are most commonly misunderstood by Kansas Registered Investment Advisers. It is recommended that all Kansas Registered Investment Advisers review the statutes and regulations that pertain to their business activities.**

## ***ETHICAL STANDARDS***

**K.A.R. 81-14-5(c)** states that, “Each person registered as an investment adviser or investment adviser representative under the act shall not fail to observe high standards of commercial honor and just and equitable principles of trade in the conduct of the person’s business. An investment adviser is a fiduciary and shall act primarily for the benefit of its clients.” It is under K.A.R. 81-14-5 that you will find specific conduct considered to be dishonest or unethical, disclosures required to be made to clients, the requirements to be met in the circumstances where a cash fee is paid to a solicitor and procedures for agency cross transactions.

## ***FILINGS***

### ***ANNUAL RENEWAL***

**K.A.R. 81-14-1(b)(2)** states that, “The application for annual renewal registration as an investment adviser shall be filed with the IARD. The application for annual renewal registration shall include the fee required by K.A.R. 81-14-2 and any reasonable fee charged by FINRA for filing through the IARD system.”

A letter is sent annually from this office reminding investment advisers of the renewal requirement.

### ***ADV UPDATES AND AMENDMENTS***

**K.A.R. 81-14-1(b)(3)(A)** states that, “Each investment adviser shall file with IARD, in accordance with the instructions in form ADV, any amendments to the investment adviser’s form ADV. An amendment shall be considered to be filed promptly if the amendment is filed within 30 days of the event that requires the filing of the amendment.”

This regulation refers to changes made during the fiscal year to specific items within the Form ADV, Parts I and II. If a change is made on a particular page of the ADV Part II, the date at the top of that particular page must be changed to indicate when the change was made.

**K.A.R. 81-14-1(b)(3)(B)** states that, “Within 90 days after the end of an investment adviser’s fiscal year, the investment adviser shall file with the IARD an annual updating amendment to form ADV.”

This regulation refers to the annual review of the ADV, Parts I and II that must be

done by each investment adviser to insure that the information on file is current and correct. At the time of the annual review, the dates at the top of all of the pages of the ADV, Part II must be changed to reflect the date of the review. This document must not be submitted until after the end of the adviser's fiscal year.

**K.A.R. 81-14-6(d)** says that "Any documents or fees required to be filed with the administrator that are not permitted to be filed with or cannot be accepted by the IARD or CRD shall be filed directly with the administrator."

Form ADV consists of both Part I and Part II, which are web-based documents that must be filed annually through IARD.

#### *FORM U-4 FILINGS*

**K.A.R. 81-14-1(c)(3)** states that, "Each investment adviser representative shall be under a continuing obligation to update the information required by form U-4 as changes occur. Each investment adviser representative and any associated investment adviser shall file promptly with CRD any amendments to the representative's form U-4. An amendment shall be considered to be filed promptly if the amendment is filed within 30 days of the event that requires the filing of the amendment."

#### *FORM U-5 FILINGS*

**K.A.R. 81-14-1(f)(2)** states that, "When an investment adviser representative's association with an investment adviser is discontinued or terminated, the investment adviser shall immediately file a form U-5 with the CRD. If the investment adviser representative commences association with another investment adviser, that investment adviser shall file an initial application for registration for the investment adviser representative."

#### *FORM ADV-W FILINGS*

**K.A.R. 81-14-1(f)(3)** states that, "If an investment adviser desires to withdraw from registration or if registration is terminated by the administrator, the investment adviser shall immediately file a form ADV-W with the IARD. The form ADV-W shall be completed in accordance with the instructions to the form."

**K.A.R. 81-14-1(f)(4)** states that, "Termination of an investment adviser's registration for any reason shall automatically constitute cancellation of the registration of each investment adviser representative that is affiliated with the investment adviser."

## **RECORDKEEPING REQUIREMENTS/EXAMINATIONS**

### **RECORDKEEPING**

**K.A.R. 81-14-4** states the records that must be maintained by a state registered investment adviser. This regulation should be reviewed in detail in order to insure that all records required are maintained.

### **EXAMINATIONS**

**K.S.A. 17-12a411(d)** states, in part, that, “[t]he records of every person issuing or guaranteeing any securities subject to the provisions of this act and of every broker-dealer, agent, investment adviser, or investment adviser representative registered or required to be registered under this act are subject to such reasonable periodic, special, or other audits or inspections by a representative of the administrator, within or without this state, as the administrator considers necessary or appropriate in the public interest and for the protection of investors. An audit or inspection may be made at any time and without prior notice.”

When an examination of a state registered investment adviser is initiated, a document request list will be presented to the investment adviser. In order that you might be prepared for an examination, we have listed the items included in the initial request. This list is not all-inclusive and additional documents may be requested during the course of the examination.

### ***Document Request List***

Records to be provided:

1. List of currently employed investment adviser representatives including their name, title, hire date, CRD number, supervisor’s name;
2. List of current, non-registered employees including name, title and hire date;
3. List of employees terminated within the past 12 months including name, title, hire date, termination date, CRD number, last two quarters of compensation, and reason for termination;
4. Written description explaining the method for the retention, preservation, and archiving of email;
5. Written description explaining the method for ensuring the security of

information on the firm's computer system and the firm's computer backup procedures;

6. Most recent Form ADV Part II and any disclosure document given in conjunction with or in lieu of Part II;
7. Annual Privacy Notice;
8. Disclosure Notice(s);
9. Discretionary and/or Power of Attorney Document;
10. Fee Schedule;
11. Current standard advisory contracts or agreements;
12. List of any account to which the investment adviser or any affiliated person serves as a trustee;
13. List of litigation which Registrant has been a party to for the last 5 years, including a brief description of any dispute and its current status;
14. Written supervisory policies and procedures;
15. List of current investment advisory clients including;
  - **The client's name**
  - **Account number**
  - **Current balance of client's assets under management**
  - **Address**
  - **Type of service provided**
  - **Whether the account involves discretion and/or control of customer funds**
  - **Name of the broker/dealer that maintains the client's securities account;**
16. List of investment advisory clients that have left your company within the past twelve months including;
  - **Client's name**
  - **Account number**
  - **Address**
  - **Date the client terminated their relationship with your company**
  - **Brief description explaining why the client ceased their relationship with your company;**
17. For Registrant or its related persons having custody or possession of or

- access to any client funds or securities;
- **The current market value of all assets in possession or to which access is available**
  - **Locations where such assets are held or the names of the custodians holding them;**
18. List of all clients directly or indirectly related to Registrant or any of its affiliated/ related persons, showing:
- **Name of clients**
  - **The party to which they are related;**
19. Employee personal securities transaction records:
- **Employee's name**
  - **Account number**
  - **Type of account**
  - **Where the account is held**
  - **Provide a copy of the most recent two brokerage statements;**
20. Promotional brochures, pamphlets, or other materials furnished to clients or prospective clients within the past thirty-six (36) months, including seminar materials, business cards and letterhead;
21. Advertisements and other sales literature for the last thirty-six (36) months;
22. All accounts, books, and internal working papers that form the basis of any performance or rates of return used in advertisements, for the last thirty-six (36) months;
23. Any composite or representative performance reports, data or graphs disseminated to clients or prospective clients (could be client specific or generalized), in the past twelve (12) months;
24. List of all parties to whom cash referral fees have been paid during the past twenty-four (24) months;
25. List of clients for whom financial plans were begun or completed in the prior twelve (12) months, showing fees charged;
26. List of all investment partnership, trust or any other pooled investment vehicle formulated or offered by Registrant or any associated person, client or prospective client. For these investments, provide all offering memoranda, financial statements and agreements, as applicable, and all reports sent to limited partners for the prior twelve (12) months;

27. List of all clients who have instructed Registrant to direct brokerage to particular broker-dealers, including the name of the brokerage firm and the client's purpose for such direction, if known;
28. Registrant's most recent financial statements, including balance sheets, trial balances and income statements;
29. List of broker-dealers affiliated with the Registrant or any related persons;
30. List of all broker-dealers used by the Registrant and the sum total of commissions paid to the Registrant during the past two (2) years;
31. List of all seminars conducted in connection with your investment adviser business for the preceeding 36 months. The list shall identify the date and location of the seminar as well as a list of attendees. Include a printout of the material covered during the seminar, or in the case of an electronic file, i.e., PowerPoint, an electronic copy on CD disk;

***Records to be available onsite:***

32. General ledgers and any subsidiary ledgers that form the basis of Registrant's financial statements for the past twelve (12) months;
33. All current loan agreements, notes payable and notes receivable;
34. All bills and statements, paid or unpaid, presented to or issued by Registrant for the last twelve (12) months;
35. Minutes of the board of directors' meetings, articles of incorporation, corporate bylaws and stock transfer records or partnership agreements, as applicable, for the past twelve (12) months;
36. Brokerage account statements and transaction confirmations for all proprietary trading or investment accounts for the past twelve (12) months;
37. Any documents giving Registrant authority over client's assets;
38. Correspondence with any regulatory agencies or self-regulatory organization;
39. Client files;
40. Monthly client account statements covering the past 24 months;

41. Order tickets and confirmations covering the past 24 months;
42. Written information for each client that forms the basis of suitability determinations;
43. Correspondence file;
44. Complaint file to include all written complaints and matters involving litigation;
45. Copy of current agreements concerning soft dollar arrangements; and
46. Employee files.

It is understood that some items may not be applicable to your particular business and therefore no information is available. In that case, you may note on the document request list that a particular item is not applicable.

## **RECORD RETENTION**

**K.A.R. 81-14-4(f)** specifies requirements for the preservation of records, both form and the length of time the records must be maintained in the principal office of the investment adviser and the length of time that they must be maintained and preserved in an easily accessible place.

**K.A.R. 81-14-4(h)** states that, “[t]he records required by this regulation may be maintained and preserved by electronic imaging or by photograph on film. Any investment adviser may also maintain and preserve records on computer tape, disk, or other computer storage medium, if, in the ordinary course of the adviser’s business, the records are created by the adviser on electronic media or received by the adviser solely on electronic media or by electronic data transmission. In whatever form, the records shall be maintained and preserved for the time required by this regulation.” The regulation goes on to state the criteria for the maintenance of such records.

This regulation permits the scanning of documents received in paper form provided you satisfy the criteria in **K.A.R. 81-14-4(h)** related to indexing, storing and retrieving the scanned documents.



## SUITABILITY DETERMINATION

**K.A.R. 81-14-4(b)(18)** states that, “[e]ach investment adviser shall maintain written information about each investment advisory client that is the basis for making any recommendation or providing any investment advice to the client.” At a minimum, such information should include:

1. Date of Birth
2. Financial Information (i.e. liquid net worth, annual salary)
3. Employment Information
4. Investment Objectives
5. Investment Experience
6. Risk Tolerance
7. Tax Bracket

It is expected that this information would be part of all client files.

## WRITTEN SUPERVISORY PROCEDURES

**K.A.R. 81-14-4(b)(19)** states that, “[e]ach investment adviser shall maintain written procedures to supervise the activities of employees and investment adviser representatives that are reasonably designed to achieve compliance with the act and these regulations.”

An investment adviser has a duty to supervise its employees, as part of its overall duty to protect the interests of its clients and insure compliance with regulatory requirements. However, there are few rules telling them in detail how to set up their supervisory procedures. Each adviser must create its own supervisory procedures, tailored to the needs of its business. A small sole proprietor may have a few simple procedures for reporting requirements, maintaining books and records and verifying transactions. A large adviser with multiple investment adviser representatives should have formal written supervisory procedures designed to monitor all aspects of its business.

The investment adviser representatives of many advisers are also registered as agents of separate broker-dealers. All FINRA member firms must comply with the supervisory requirements spelled out in the NASD Conduct Rules. NASD Notice to Members 94-44 makes it clear that broker-dealers have an obligation to supervise the outside securities business of its agents, including investment advisory business. ***However, just because the broker-dealer’s compliance department may be reviewing the investment adviser representative’s conduct does not mean that the adviser can abdicate its own supervisory responsibilities.***

**K.A.R. 81-14-10(a)(2)** lists the factors to be considered when we determine whether the supervisory procedures are reasonably designed. These factors are:

- the firm's size;
- the organizational structure;
- the scope of business activities;
- the number and location of the offices;
- the nature and complexity of products and services offered;
- the volume of business done;
- the number of investment adviser representatives assigned to a location;
- the specification of the office as a non-branch location; and
- the disciplinary history of the registered investment adviser representatives.

### *Supervisory Areas of Consideration:*

**Hiring and Training** - Advisers with more than one employee should have some procedures for screening new personnel for qualifications and disciplinary history. Many advisers have minimum education and experience standards for investment adviser representatives, which should be disclosed on ADV Part II, Question 5. The adviser should develop a system for training new employees and keeping its other employees current on new regulations and other industry issues.

**Investment Adviser Representative Registration** - Advisers should have procedures to insure that all investment adviser representatives are properly registered. These procedures should provide for timely disclosure of disciplinary events on Form U-4, and the timely filing of Form U-5 for terminated investment adviser representatives.

**Transaction Review** - Advisers that execute securities trades for clients should review their daily transactions for several issues. The adviser should compare the transaction information received from the custodian against its own internal trade blotter. It should also compare trades in different customer accounts to be sure that some accounts are not favored over others by receiving better executions. Many advisers require block trades to avoid this problem. The adviser should also periodically evaluate transactions for execution quality.

**Correspondence Review** - Advisers with multiple investment adviser representatives should have procedures for monitoring incoming and outgoing correspondence. This review enables the adviser to detect evidence of sales practice abuses and other violations of the adviser's policies. Advisers with more investment adviser representatives and/or more correspondence should have more formal procedures in this area.

**Advertising/Sales Literature Review** - All advertising or sales literature used by the adviser should be approved by a supervisor prior to use. The use of testimonials must be prohibited. The supervisor should carefully review advertising using past recommendations and performance information to ensure that it is not misleading and contains the proper disclosures.

**Keeping Disclosure Document Current** - The adviser's supervisory procedures should indicate who is responsible for keeping the Form ADV and any alternate disclosure documents up to date. It should also have a set procedure for filing updates to its disclosure documents and advisory contracts with the relevant jurisdictions.

**Distribution of Disclosure Document** - The adviser should have procedures designed to ensure that new clients receive the adviser's disclosure document. An investment adviser shall, at least once a year and without charge, deliver or offer in writing to deliver to each of its clients the current brochure and any current brochure supplements. If a client accepts the written offer, the investment adviser shall send the current brochure and supplements to that client within seven days after the investment adviser is notified of the acceptance.

**Branch Office Audits** - Advisers that maintain multiple branch offices should conduct periodic audits of these offices. The adviser's procedures should include the audit schedule, a description of the areas to be reviewed during an audit, and a system for maintaining internal audit records.

**Investment Adviser Representative Securities Activity Review** - All advisers should have policies regarding the personal securities transactions of their investment adviser representatives. This is particularly important for advisers that execute trades for their clients. Advisers must be careful that their investment adviser representatives do not make personal trades ahead of client trades, or in any way seek to benefit from knowledge of the advice given to clients. Advisers should receive copies of statements for all clients. These statements should be reviewed, and this review should be evidenced. Many advisers that execute customer trades also have specific rules prohibiting personal trades in securities recommended by the adviser.

**Complaint Review** - A supervisor should review all complaints against an adviser.

The complaint review procedure should indicate who conducts this review, how the adviser communicates with the client, how complaints are resolved, and how complaint-related records are maintained.

**New Account Approval** - Advisers should have specific procedures for review and approval of all new client accounts by a supervisor. The supervisor should review new account documents to ensure that sufficient financial background and investment objective information has been gathered. He or she should also determine whether the client is suitable for the services recommended, and whether the client meets the adviser's minimum net worth or account size standards.

**Client Account Activity Review** - Advisers should periodically review the activity in each client account to be sure that it is consistent with the client's investment objectives and financial profile. The adviser's procedures should indicate the schedule for these reviews. These procedures should be consistent with the account review procedures disclosed on Form ADV Part II, Question 11.

**Handling of Client Funds/Securities** - All advisers should have detailed procedures for the handling of client funds and securities. For the protection of the client and of the adviser, these procedures should include internal controls appropriate for the size of the adviser and its business. At a minimum, the procedures should specify who is responsible for each step of the process, from receiving a deposit from a client to forwarding or depositing the item. The procedures should also indicate the records maintained to document this process. If possible, one person should not be responsible for the entire process.

**Maintenance of Books and Records** - The adviser should have a system for maintaining its books and records. The books and records procedures should specify who is responsible for each type of records, and how long the records are maintained. If possible, one person should not be responsible for creating, maintaining, and destroying records.

**Segregation of Incompatible Duties** - To the greatest extent possible, duties pertaining to cash transactions, custody, recording and reconciling of client funds and securities and the creation, maintenance and destruction of records should be performed by different persons so that one person is not responsible for all duties.

**Misuse of Nonpublic Information** - All advisers should establish, maintain, and enforce written procedures designed to prevent the misuse of material nonpublic information and prohibit trading on "inside information".

**Supervisory System Review** - One of the adviser's principals should be responsible for keeping the firm's supervisory procedures up to date. The adviser should document when revised procedures have been distributed to its

investment adviser representatives.

## ***NET WORTH/SURETY BOND***

### ***NET WORTH***

According to **K.A.R. 81-14-9(d)**, each investment adviser that has custody of client funds or securities shall maintain at all times a minimum adjusted net worth of \$35,000. Similarly, each investment adviser that has discretionary authority over client funds or securities but does not have custody of client funds or securities shall maintain at all times a minimum adjusted net worth of \$10,000. For purposes of the regulation, adjusted net worth means the excess of assets over liabilities as determined according to generally accepted accounting principles, except that assets shall not include those items noted under **K.A.R. 81-14-9(d)(1)**. Exceptions to the net worth requirement are stated under **K.A.R. 81-14-9(d)(2)(A) through (C)**.

If an investment adviser fails to maintain the minimum adjusted net worth, the adviser must give notice to the Securities Commissioner as set forth in **K.A.R. 81-14-9(d)(5)**.

### ***SURETY BOND***

According to **K.A.R. 81-14-9(e)**, every investment adviser that has custody or discretionary authority over client funds or securities shall be bonded for at least \$35,000. The bond shall be in a form acceptable to the Securities Commissioner from a bonding company qualified to do business in Kansas, and the bond shall be subject to the claims of all clients of the investment adviser regardless of each client's state of residence.

If an investment adviser does not meet the minimum adjusted net worth requirement, the investment adviser shall also be bonded for the amount of the net worth deficiency rounded up to the nearest \$5,000. However, an investment adviser is exempt from the requirements of **K.A.R. 81-14-9(e)** if the adviser meets at least one of the following requirements:

- Maintains a minimum adjusted net worth that exceeds the requirements of **K.A.R. 81-14-9(d)** by at least \$35,000;
- Qualifies for an exception from the minimum adjusted net worth requirements under **K.A.R. 81-14-9(d)(3)** and does not have discretionary authority; or
- Has its principal place of business in a state other than Kansas, is properly registered in that state and satisfies the bonding requirements of that state.



**Commissioner  
Chris Biggs**

“Part of the mission of the Office of the Kansas Securities Commissioner is to promote integrity and full disclosure in financial services. We want to work with you to achieve that goal and we welcome your input and questions.”

A handwritten signature in blue ink, appearing to read "Chris Biggs".

**Scam Hotline:  
1-888-40-SCAMS**

**Business Calls  
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**Voice - 785-296-3307 • Fax 785-296-6872**

**Wichita**

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